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13	D/EEO				
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15	D/OEA				
16	C/PAD/OEA				
17	SA/IA				
18	AO/DCI				
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Date

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Executive Secretary

5/27/82

Date

3637 (10-81)

THE WHITE HOUSE
WASHINGTON

Executive Registry
82-1438

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: May 26, 1982 NUMBER: 068965CA DUE BY: ---------

SUBJECT: CABINET COUNCIL ON ECONOMIC AFFAIRS -- MEETING -- May 27, 1982

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	✓	☐
State	✓	☐
Treasury	✓	☐
Defense	☐	✓
Attorney General	☐	✓
Interior	☐	✓
Agriculture	✓	☐
Commerce	✓	☐
Labor	✓	☐
HHS	☐	✓
HUD	✓	☐
Transportation	✓	☐
Energy	☐	✓
Education	☐	✓
Counsellor	✓	☐
OMB	✓	☐
CIA	☐	✓
UN	☐	✓
USTR	✓	☐
CEA	✓	☐
CEQ	☐	☐
OSTP	☐	☐
______	☐	☐
______	☐	☐

	ACTION	FYI
Baker	✓	☐
Deaver	☐	☐
Clark	✓	☐
Darman *(For WH Staffing)*	✓	☐
Harper	✓	☐
Jenkins	☐	✓
Gray	☐	☐
______	☐	☐
______	☐	☐
______	☐	☐
______	☐	☐
______	☐	☐
______	☐	☐
CCCT/Kass	☐	☐
CCEA/Porter	✓	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: The Cabinet Council on Economic Affairs will meet tomorrow, May 27, at 8:45 AM in the Roosevelt Room. The agenda and background paper for item #2 are attached. The paper on item #1 was distributed to you on May 17.

MAY 26 6 37 PM '82
ER

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

✓ Becky Norton Dunlop
Director, Office of
Cabinet Affairs
456-2800

THE WHITE HOUSE

WASHINGTON

May 25, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the May 27 Meeting

The agenda and papers for the Thursday, May 27, meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is a review of the economic adjustments to lower inflation. A paper, prepared by the Council of Economic Advisers, providing a framework for considering economic adjustments to lower inflation, was distributed to Council members on May 17.

The second agenda item is a review of currency exchange rate movements. The subject of international currencies, what influences their movements, and how one evaluates claims that a particular currency is "overvalued" or "undervalued" has come up from time to time at Cabinet Council discussions in recent months. Under Secretary of the Treasury for Monetary Affairs Beryl Sprinkel has prepared a paper, in coordination with the Council of Economic Advisers, on "Determinants of Exchange Rate Movements," to serve as a basis for discussion.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

May 27, 1982

8:45 a.m.

Roosevelt Room

AGENDA

1. Economic Adjustments to Lower Inflation (CM#249)

2. International Currency Exchange Rate Movements (CM#256)

THE UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS
WASHINGTON, D.C. 20220

CM-256

May 25, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

From: Beryl W. Sprinkel BWS

Subject: Determinants of Exchange Rate Movements

Attempts aimed at identifying principal factors influencing exchange rate movements have a long history.

The three most popular theories of exchange rate determination focused on relative price levels, interest rate differentials and current account positions among various countries. While each of these alternative theories has more than a grain of truth to it, in the real world the observed connection between exchange rate movements and their postulated determinants is very imprecise.

There are several reasons for the tenuousness of this connection. First, the causality runs both ways: while exchange rates are influenced by relative inflation and interest rates, and current account positions, those variables are themselves influenced by exchange rate changes. Second, each individual theory by focusing on a specific set of factors provides only a partial explanation of exchange rate movements. Third, the influence of shifts, say, in the inflation differential among countries on exchange rates is felt with a (usually unpredictable) lag. But, perhaps, the most glaring deficiency of popular approaches to exchange rate determination is their disregard for expectations.

Modern theories of exchange rate determination make an attempt to take expectations into account. The simplest exposition of these theories would entail a comparison between the rates of growth of money supply relative to output in different countries. The rationale for this approach is that excess supply of money predetermines the future rate of inflation while the relative future rates of inflation in various countries, as expected today, govern current exchange rate movements. This approach is reasonably well suited for explaining long-term trends, but is generally inadequate for explaining medium-term exchange rate movements.

Even the most sophisticated modern models of exchange rate determination that attempt to integrate many explanatory factors have proven unable to adequately account for the impact of volatile expectations about the future economic and political environment on exchange rates.

In summary, one could reach the following conclusions:

(1) No single factor or set of factors can explain adequately exchange rate movements.

(2) Exchange rates move more rapidly than the identifiable factors supposed to influence them.

(3) Exchange rate movements are dominated by volatile expectations about the future.

(4) With the knowledge currently available, it is impossible to identify what the "appropriate" exchange rate is or should be, let alone to predict future exchange rate movements.

Notes:

Exchange rates are defined as the price of foreign currency expressed in U.S. dollars and cents. Thus, downward slope reflects depreciation of the foreign currency relative to the dollar.

Panel 1

CPI ratio is computed as U.S. CPI divided by the apropriate foreign CPI; monthly data.

Panel 2

Interest rate differential is computed as foreign rate minus U.S. rate; monthly data. Interest rates for foreign countries are 3-month interbank lending rate except for Canada, finance company paper, and Japan, Gensaki rate. Interest rate for U.S. is 3-month certificate of deposit, secondary market.

Panel 3

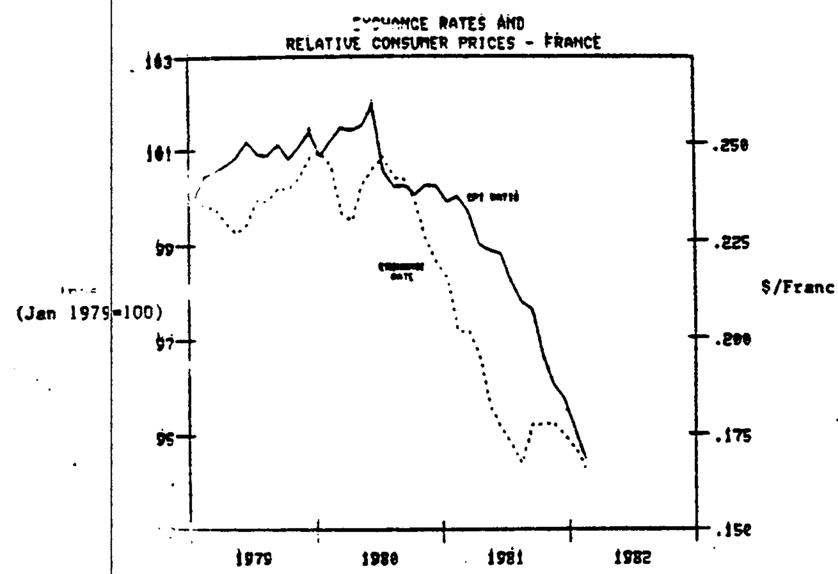
Current accounts are net exports, i.e., exports of goods and services minus imports of goods and services, national income accounts basis; quarterly data. Data are incomplete for U.K. and non-existent for Switzerland.

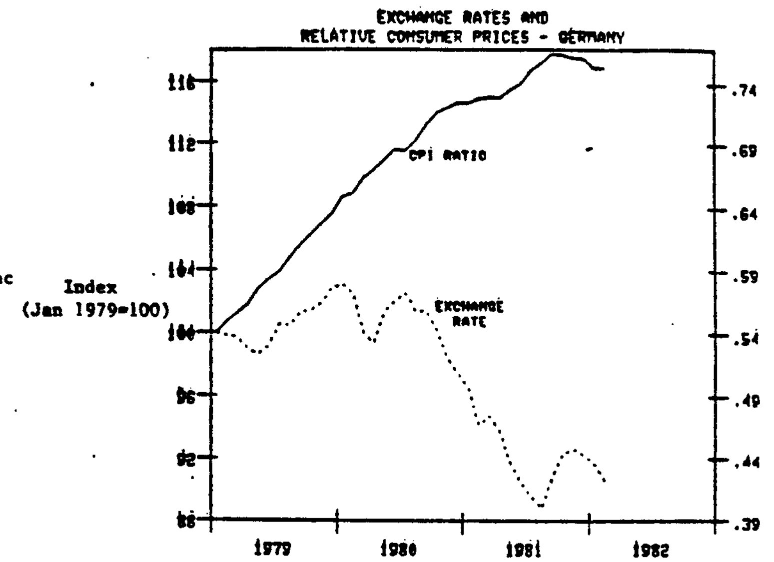
Panel 4

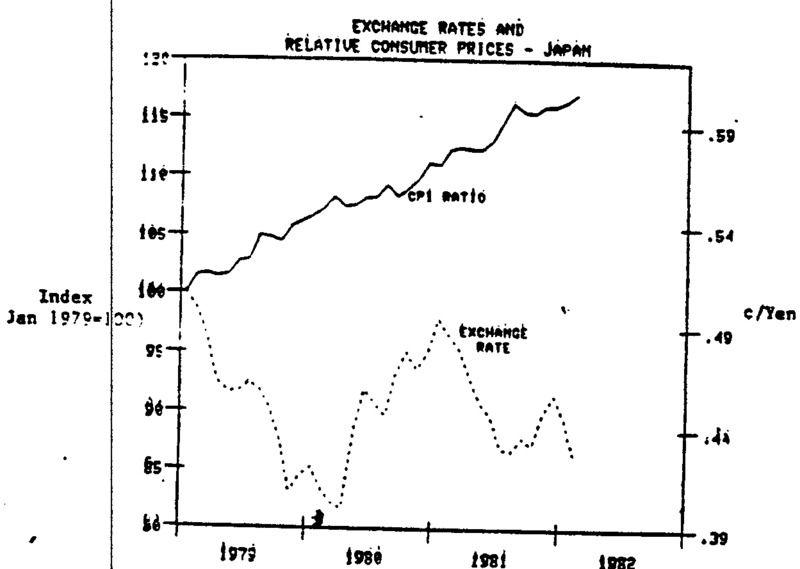
Relative excess money growth is defined as the difference between M1 growth minus real GNP growth for the U.S. and M1 growth minus real GNP growth for the foreign country; quarterly data. For France real GDP growth is used and for the U.K. the growth rate of industrial production is used (data for GNP incomplete).

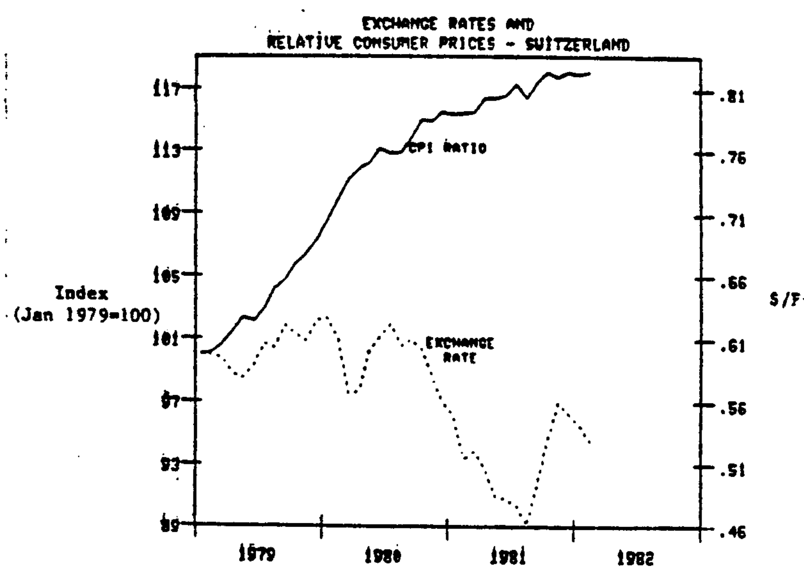
Sources: OECD: Main Economic Indicators, National Income Accounts; U.S. Department of Commerce

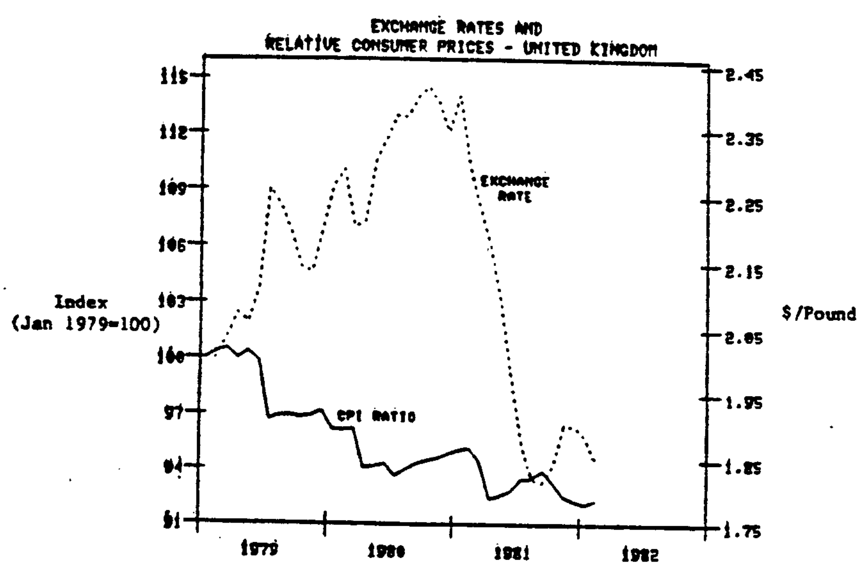
PANEL 1: PURCHASING POWER PARITY HYPOTHESIS



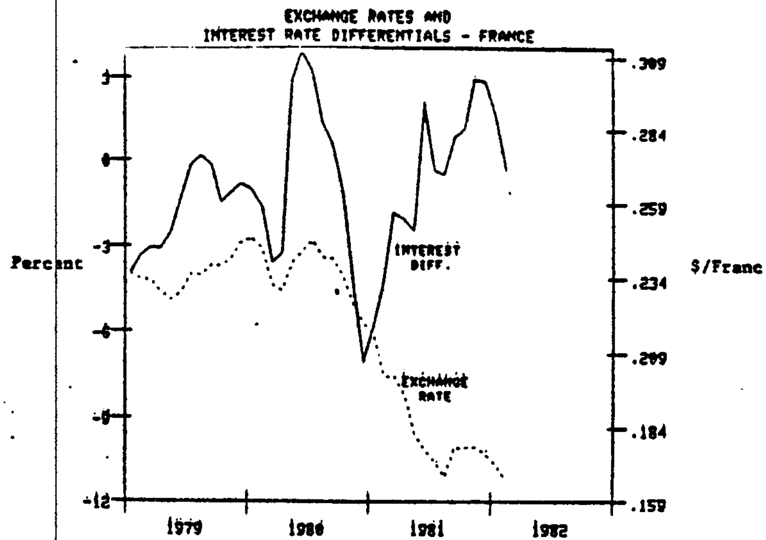


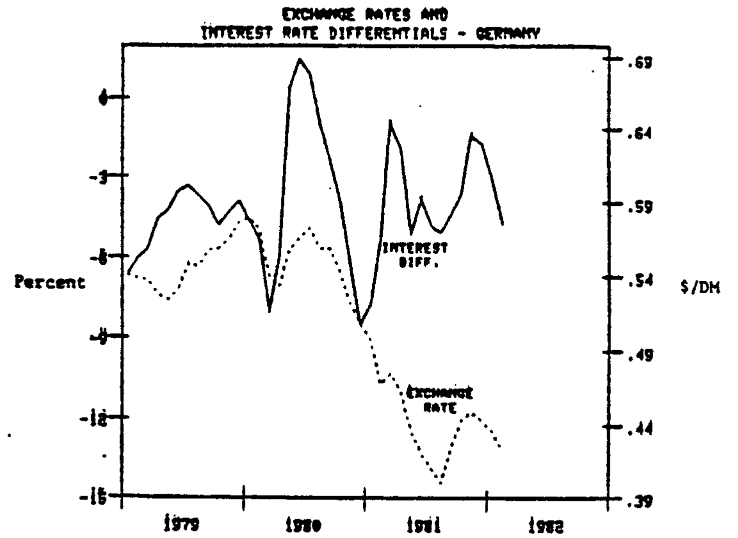


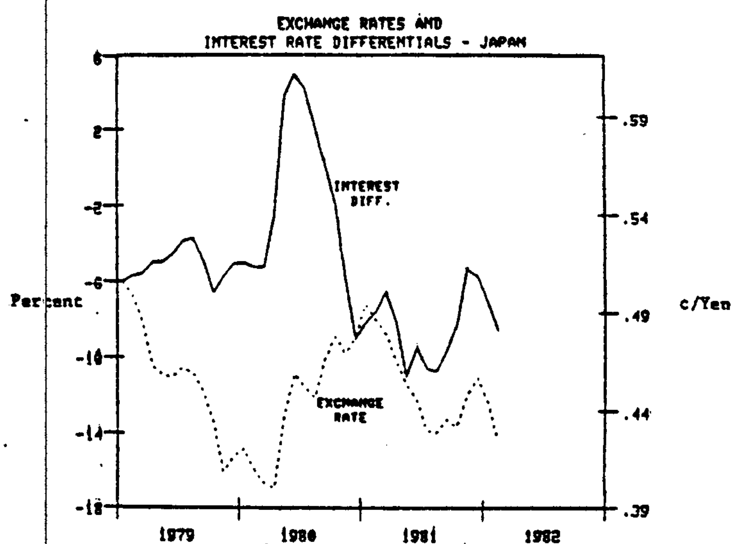


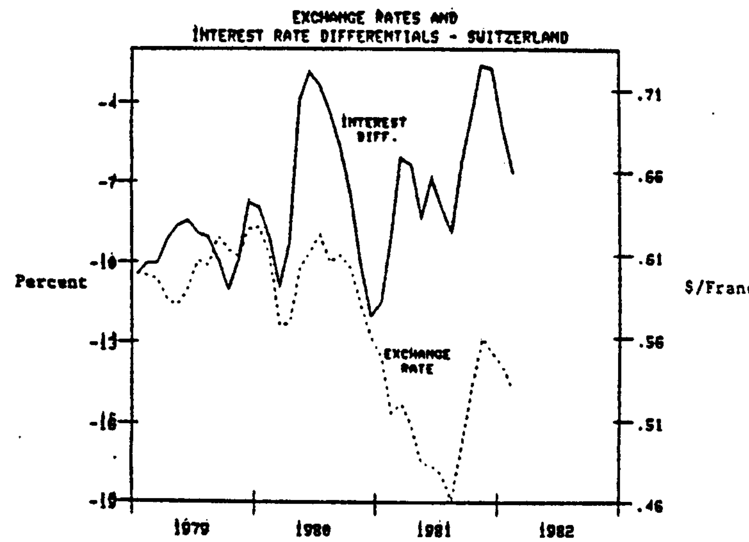


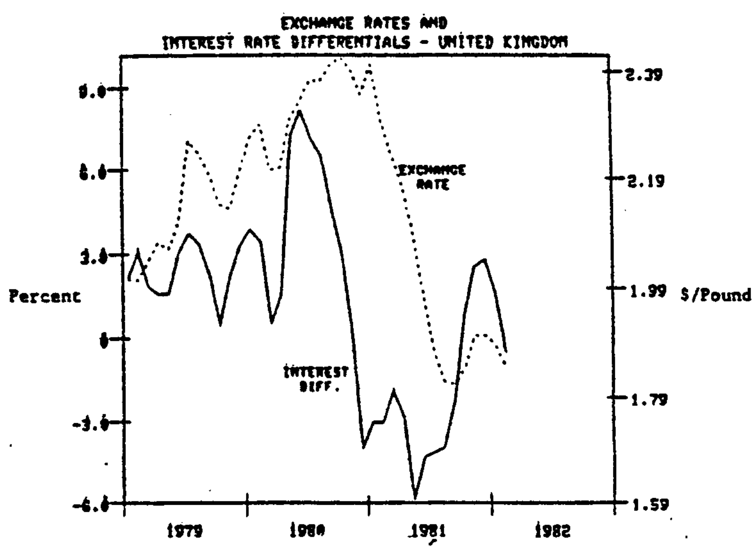
PANEL 2: INTEREST RATE PARITY HYPOTHESIS



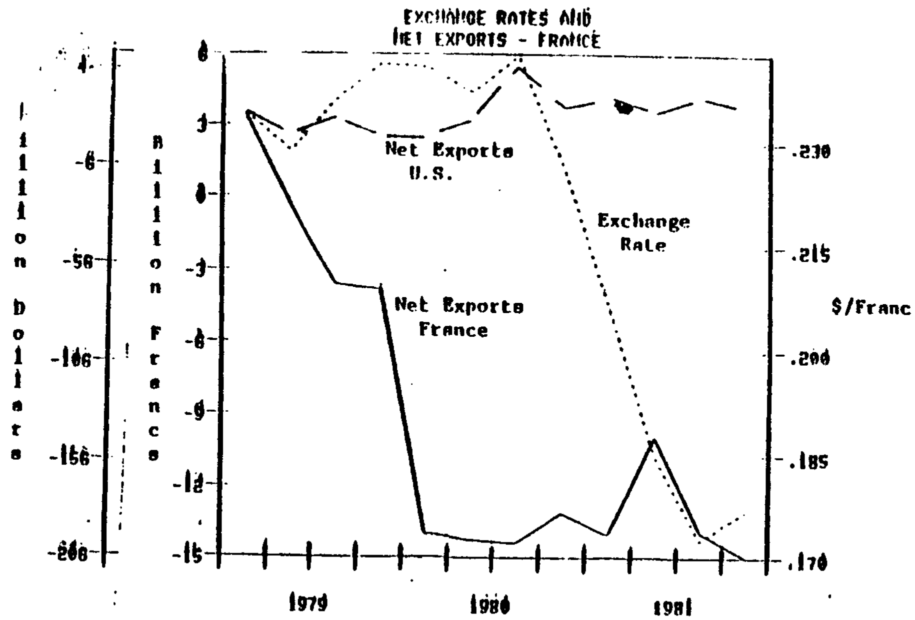


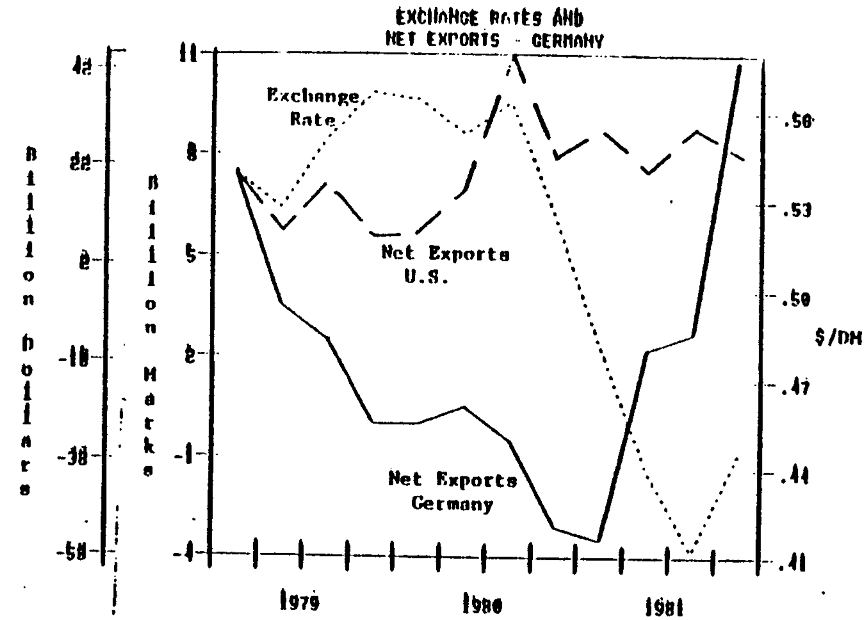


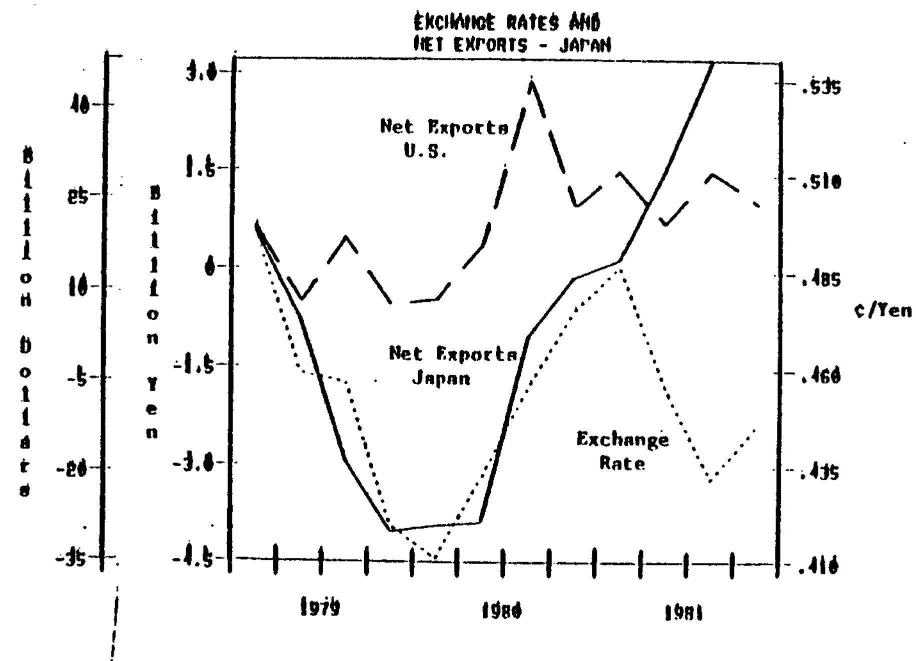




PANEL 3: CURRENT ACCOUNT HYPOTHESIS







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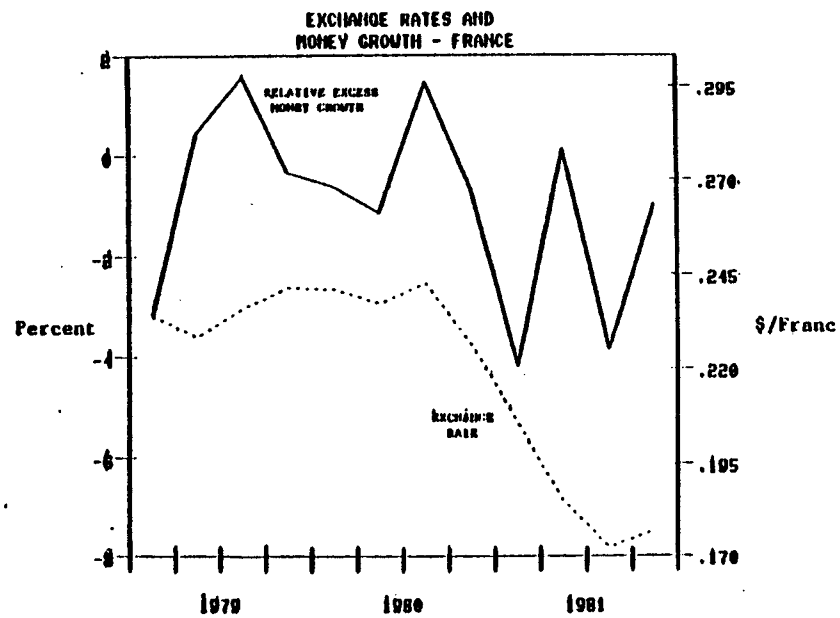
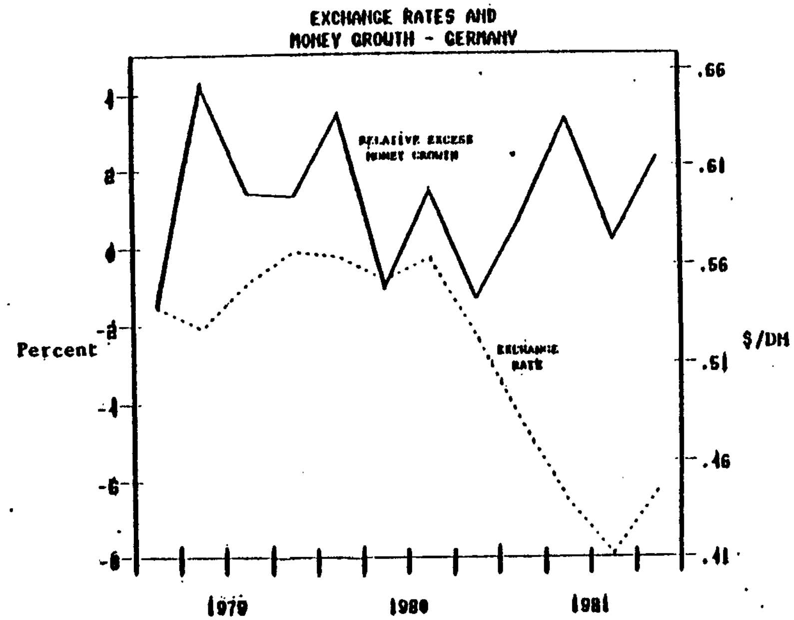
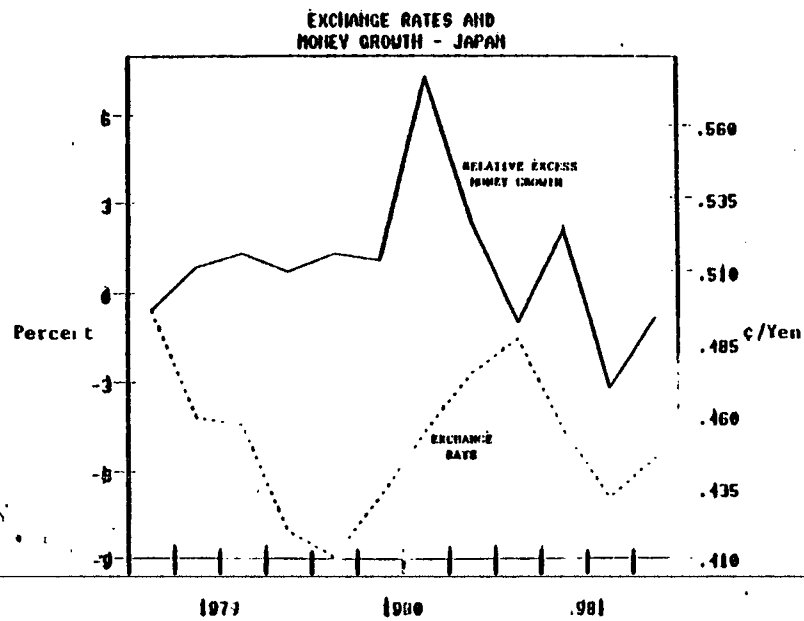
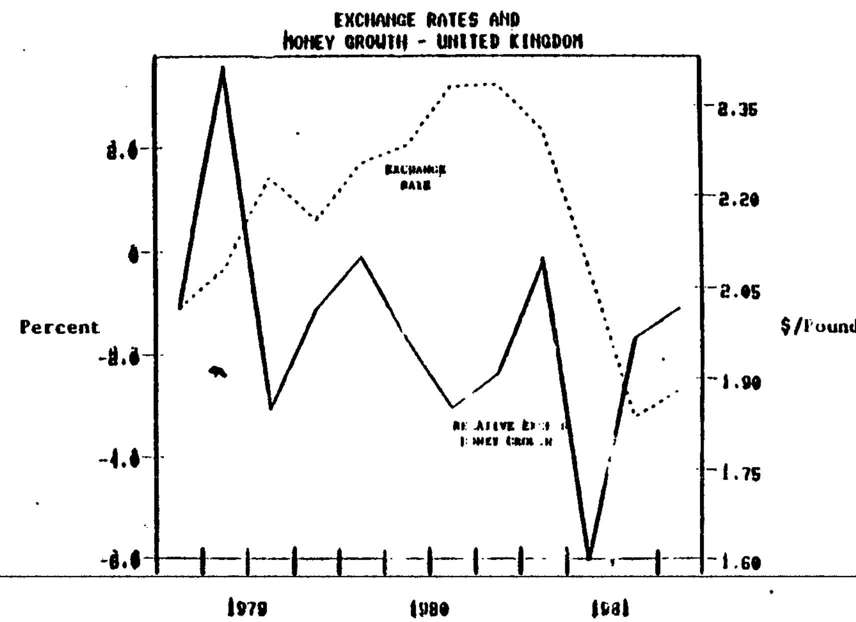
PANEL 4: MONETARY-EXPECTATIONS HYPOTHESIS









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